5-1991

International Securities Regulation: London's "Big Bang" and The European Securities Markets

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Recommended Citation
46 Bus. Law. 1351 (1990-1991)

International Securities Regulation: London's "Big Bang" and the European Securities Markets
By Norman S. Poser*

*Reviewed by Roberta S. Karmel***

For the sake of full disclosure, I note that Norman S. Poser is a colleague and a friend. Accordingly, I am delighted to be in a position to praise his retrospective on London's Big Bang as a well-organized and well-written book. Its lessons should be heeded by U.S. regulators, who frequently let domestic politics stand in the way of initiatives to counter the threat of international competition to U.S. securities markets.

Regulatory change in London over the past decade proceeded rapidly, first to accomplish economic deregulation, and then to improve investor protection. Both deregulation and reregulation in London were impelled by a policy decision by the British government to maintain London's role in the international securities markets as the primary European exchange. London assumed that role in the first place because of the ill-fated U.S. interest equalization tax which led to the development of the Eurobond market in London. Thereafter, a generally relaxed regulatory climate for securities transactions within the context of a respected system of law and bank supervision in a cosmopolitan English speaking city made London thrive as an international institutional marketplace. When the United States unfixed brokerage commission rates London also was forced to deregulate commission rates. At the same time, a series of trading scandals in the United Kingdom led to a demand for improved investor protection mechanisms. After new regulations were formulated, competitive threats from European exchanges and European Community ("EC") harmonization efforts almost immediately impelled a reregulation by the London authorities.

Professor Poser tells the story of these developments for a U.S. audience clearly and analytically. Chapter 1 discusses the paradox of simultaneous regulation and deregulation of the London securities market and raises many philosophical questions concerning the objectives and techniques of regulation.

*Boston: Little Brown and Company, 1991, 779 pages, ($125.00).

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These are questions which go to the heart of regulatory policy making. They had to be addressed when economic and legal developments forced the London stock exchange to be transformed from a fixed commission, single capacity, primarily government bond trading floor into a negotiated, dual capacity market where U.K. and international equities as well as bonds were traded in a screen based dealer market. What is the proper balance between government regulation and market discipline in stock markets? How much regulation should be done by the government and how much by self-regulatory organizations ("SROs")? Should disclosure or merit regulation be selected? In particular, how should conflict of interests be handled? Finally, what steps should be taken to accommodate national regulatory systems to the internationalization of the markets? Hopefully, the SEC is also addressing these questions at this time and planning initiatives to maintain the primacy of New York as a securities market in the face of competitive threats from London, Tokyo, and others.

Chapter 2 contains a historical summary of the events leading to the deregulation of commissions and capacity in London in October of 1986, generally referred to as "Big Bang." This chapter also outlines the changes in regulatory oversight developed in response to Big Bang, and the changes in the marketplace which ensued as the result of these legal developments and the economic forces let loose by deregulation. Just as Big Bang was a reaction to internationalization, specifically the development of the unregulated Eurosecurities markets in London, the access to the London markets given to foreign financial institutions by Big Bang was a critical factor in shaping the markets in 1986. Moreover, the development of securities regulation by the EC has been a more recent influence in causing the U.K. authorities to rewrite the statutes and regulations adopted immediately after Big Bang. Professor Poser's terse writing style and in-depth understanding of the major issues sweeping through international securities regulation over the past decade enable him to present briefly but coherently the complex interrelationship of national and international, legal and marketplace developments. Along the way, he passes critical judgment on both the regulators and the regulated, applauding the good leadership which caused the deregulation of the London Stock Exchange, eventually renamed the International Stock Exchange ("ISE") to be "pursued with vigor and enthusiasm," but criticizing such continuing problems as delayed trade reporting and inefficient clearance and settlement systems. As in the United States, deregulation of commission rates produced cutthroat competition for institutional business, but increased commission costs for the institutional investor.

Chapter 3 is an excellent and clear summary of the Financial Services Act ("FSA") which should be useful both to practitioners and scholars. It is supplemented by an Appendix containing the FSA which should help to make this book useful reference for American lawyers. Professor Poser spells out how the U.K. authorities opted first for a self-regulatory system which spelled out in minute detail the appropriate conduct for securities firms and then was forced to throw away the rule book and go to a more general set of standards with greater governmental oversight. Fear and misunderstanding of the SEC and the U.S.

experience, and a desire to avoid excessive regulation led to a rigid and unworkable system. As has frequently occurred in the United States, the securities industry and its advisors had a poorer understanding of its own self-interest than did its critics and regulators.

In addition to summarizing the framework of the FSA, Professor Poser analyzes a number of discrete subjects in depth and compares U.K. law to U.S. law. These topics are insider trading, conflicts of interest, takeovers, enforcement and civil liability, public offerings, and financial regulation. The treatment of these topics is uneven. Professor Poser's discussion of conflicts of interest is much more thoughtful and comprehensive than his discussion of other subjects, some of which, like financial regulation, are simply set forth in cursory fashion without any judgment as to their efficacy. An important difference between U.S. and U.K. law, which runs through all comparative analysis, is in the enforcement and civil liability area. Although the substance of securities regulation in the United Kingdom is quite similar to the United States, its implementation is markedly different.

Although the FSA and implementing regulations have given investors some recourse against their brokers, there is little incentive to enforce these rights in view of the prohibition against contingency fee arrangements, the rule that a losing party may be required to pay costs, and the lack of an effective class action mechanism. In the takeover area, which is governed by the Takeover Panel, a nonstatutory, self-regulatory organization, there also is far less reliance on litigation to resolve disputes, and offers generally proceed more expeditiously than in the United States and with a greater degree of investor protection. Another area of similar difference, not highlighted by Professor Poser, has to do with the more informal and flexible approach to disclosure in public offering documents, whereby there can be confidential discussions between issuers and the ISE over a sensitive disclosure item, and the extent of required disclosure can be quietly worked out. In part, this is because the ISE, rather than a government agency, passes upon disclosure documentation. London's goal of structuring similarly flexible self-regulatory bodies to oversee relations between securities firms and their customers was not achieved.

In Chapter 4 Professor Poser travels full circle in that he describes both the effect of EC securities regulation directives on the London market and the effect of developments in the United Kingdom on other European countries. Some of these countries are member states of the EC—France, Germany, The Netherlands, and Spain; others are not—Switzerland and Sweden. In all cases, internationalization of the markets has forced economic deregulation and greater investor protection regulation. Each jurisdiction has been forced to compete with the United Kingdom in order to satisfy the capital needs of its own country's corporations. At the same time, London has had to adjust its securities regulations almost as soon as they become effective in order to deal with new EC developments.

Professor Poser's summary of the securities markets and their regulation in each of the European countries surveyed is helpful and interesting, but unfortunately superficial. It would have been nice to have had a more critical comparative analysis of their strengths and weaknesses. Which of these markets will pose a real competitive threat to London—or New York—in the future is difficult to predict. France has put its hat in the ring, and as Professor Poser points out, the French Treasury Department has taken a far more active and decisive part in deregulating the markets than did its British counterpart, perhaps because the Bourse was a government-created monopoly.

The British government was wise to understand that maintaining and increasing London's importance as a financial center required legal and technological changes. To an American, the speed with which regulatory change can be accomplished in London is admirable. Although many mistakes were made along the way to modernizing securities trading and regulation, these mistakes could be corrected more quickly than under the checks and balances which exist for U.S. lawmaking.

The competitive threat which London now poses to New York should give the SEC, the U.S. banking agencies, and their congressional oversight committees pause. Special interest politics as usual in the United States is unlikely to lead to the kind of regulatory changes necessary for U.S. financial institutions to compete effectively in international markets. Just as London had to react decisively to developments in New York and the EC, Washington must now heed the strengths of non-U.S. securities markets. An effective response will involve both economic deregulation, for example, freeing financial institutions from constraints on geographical and product diversification, and reregulation, for example, better capital adequacy rules. In addition, the SEC will have to assume an international, rather than adhering to a national perspective, in fulfulling its mandate to protect investors.